

DOCUMENTS AND RETROSPECTIVES

We publish here, in Appendix A, four letters between Luigi Einaudi and John M. Keynes of the period March-April 1922 and related to Einaudi's contribution to the Manchester Guardian Supplements. Einaudi was one of the Italians invited to contribute to The Reconstruction in Europe, together with, among others, Benedetto Croce, Amedeo Giannini, Luigi Luzzatti, Francesco Saverio Nitti, and the young Piero Sraffa.

On 2 March 1922 Keynes sent Luigi Einaudi a letter of invitation to write an article for the Manchester Guardian on the financial and budgetary position of Italy. On March 8, Einaudi accepted the invitation and on April 25 he sent Keynes his article (in Italian) with the suggested title "Italian financial difficulties and prospects". On April 30 Keynes thanked Einaudi for his article. It was published in the fifth Supplement with the title "Financial prospects of Italy" and at the same time in the Italian version with the title "Le difficoltà e le previsioni finanziarie dell'Italia", on 27 July 1922. It is reproduced in Appendix B. An introductory note on the relationship between the two economists in the early 1920s precedes.

ON THE RELATIONSHIP
BETWEEN EINAUDI AND KEYNES IN THE EARLY 1920S

ROBERTO MARCHIONATTI *

The Einaudi-Keynes relationship started as far back as the beginning of the First World War in the summer of 1915. Keynes, at that time co-editor of the *Economic Journal*, had appreciated Einaudi's articles on the Italian economic situation published in the newspaper *Il Corriere della Sera* and which were pointed out to him by the other co-editor, the eminent economist Francis Y. Edgeworth. In July, he wrote to Einaudi and invited him to contribute to the English journal:

[Dear] Professor Einaudi,

Professor Edgeworth tells me that you are now writing about the Italian war loan. If you are, perhaps, able to spare the time to write a summary statement of the Italian financial position for the September «*Economic Journal*» I should be extremely obliged to you [letter of July 16, 1915, in Fondazione Luigi Einaudi of Turin, *Archivio Luigi Einaudi*, fasc. Keynes J.M. (ALEFE)].

Einaudi accepted the invitation and wrote a long article on the Italian economic situation, which was published in the December issue of the *Economic Journal*.

Thereafter, the two economists showed interest in, and appreciation for, each other's positions expressed between the wartime period and the early 1920s. At that time they largely agreed on what should be done in Europe. Only in the second half of the 1920s did their views begin to diverge, to the point that in many respects they became antagonistic.¹ In any case, their first exchange established a good relationship between the two economists. Keynes was in his thirties and he was internationally known among economists thanks to his 1913 book *Indian Currency and Finance*, which was much

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¹ On the relationship between Einaudi and Keynes see: FORTE (1982), MARCHIONATTI (1999), LUNGHINI (2004), FORTE and MARCHIONATTI (2011), FORTE (2016).

appreciated by Einaudi.² At that time Einaudi was in his early forties (he was born in 1874), and was well known as a scholar and journalist. Professor of Public Finance at the University of Torino and at Bocconi University in Milano, he was the author of books on public finance and economic history, editor of *Riforma Sociale*, and Italian correspondent of *The Economist*.³ The good relationship between the two economists is testified by their correspondence. In a letter to Einaudi of February 1916, Keynes – at that time working at the British Treasury – praised an article by Einaudi on “the freight difficulties”, and declared that he had “a great deal to do officially with our financial relations with Italy” (letter of February 14, 1916).

In February 1920, Einaudi enthusiastically reviewed *The Economic Consequences of the Peace* (Einaudi 1920) in the *Corriere della Sera*. He endorsed Keynes’ critique of the Versailles Treaty. A few days later, Einaudi wrote to Keynes to reiterate his appreciation:

Dear Sir,

I have just finished reading your “Economic Consequences of the peace”. A truly fascinating book. I think your book will have a great influence on remodelling the European attitude towards the peace (letter of January 23, 1920, in ALEFE).

But he also wrote that Keynes’ book had described the Italian budgetary position in “a little too pessimistic” terms and that, in any case, the Italian economic situation was improving. Keynes replied at the beginning of March and acknowledged that Einaudi was right:

I am very glad that you think I take a too pessimistic view of the Italian budgetary position. The progress made by Italy, since I wrote my book, towards balancing the foreign trade has been markedly more successful than what France has done during the same period (letter of March 2, 1920, ALEFE).

After some months, Einaudi again cited with admiration Keynes’ *Consequences* in an article in *The Economist*:

As you have so truly remarked, and as Mr. Keynes has admirably put in his book, the external debt will be a source of great embarrassment for the Italian Budget, for our foreign balance of payment, and a source of lasting friction between Italy and her allies (Einaudi 1920 June 12).

² In a review of *Modern Currency Reforms* by the American economist E.W. Kemmerer published in *Riforma Sociale*, the journal of the Torino School economists, in October 1917, Einaudi cited Keynes’ book, and called it a “classic book in terms of style, profoundness and clearness of reasoning”: an opinion that Einaudi reaffirmed 30 years later in his obituary on Keynes.

³ On Einaudi and the *Economist* see: MARCHIONATTI (1999).

In two articles of January 26 and April 7, 1922, in the *Corriere*, Einaudi positively reviewed *A Revision of the Treaty* and Keynes' thesis that the reparation clauses written into the Versailles Treaty were over-severe and that Great Britain and America should cancel all the debt of the European countries and waive their claims to any share of German reparations. Two years later, in September 1924, the Dawes Plan came into effect. Einaudi was rather critical of the Plan, while Keynes substantially agreed with it. Einaudi's criticism centred on the fact that the Dawes plan broke the concomitance of the resolution of German reparations and inter-allied debts. On 10 January 1925, the *Corriere* published – simultaneously with its publication in *The Nation* – an article by Keynes (1925) in which he accepted, with some caution, the Dawes Plan's logic. In a brief foreword Einaudi stated that he did not share Keynes' opinion, and some days later, on January 3, in an article entitled "Questioni di principio e soluzioni concrete", he confirmed his opinion and reproached Keynes for suffering, according to him, from a "short memory".

By that time the relationship between the two economists had deteriorated. The cause was another crucial issue of the time: monetary stabilization. On this issue Einaudi and Keynes had been of the same opinion until 1922. On 29 April 1922, in the *Corriere*, Einaudi widely quoted from a Keynes' article on the Genoa Conference being held in those days (Keynes 1922), and at which Keynes maintained that stabilization of European currencies was necessary, but not their return to the pre-war level, and he recognized that the return to gold at the pre-war parity was a utopia:

The return of the lira to the prewar gold parity means increasing unemployment and decreasing wages ... There is only a social class which is interested in the return to the old parity: the bourgeois middle class, owner of real estates and long term fixed-rate government bonds. However, this class should not be interested in rapid revaluation of the lira, because to escape the Scylla of high prices it would fall into the Charybdis of State bankruptcy.

The following day, in the letter of April 30, Keynes, while thanking Einaudi for sending the expected article on Italian financial prospects to be published in the *Manchester Guardian*, wrote:

I was most delighted to read your article in yesterday's *Corriere* commenting on myself. I half thought when I wrote that I might perhaps be giving you a good opportunity for speaking out decisively on this matter. Although I am a little more optimistic that you are about the possibilities of the situation, there is really very little difference between our opinions. We both agree that the immediate problem is to persuade the world that a return to the pre-war parity is an absurdity and that the next thing to do is to concentrate on some method of avoiding the present seasonal fluctuation, which can perhaps be treated separately from the more dif-

ficult problem of progressive depreciation due to unsound Government finance (letter of April 30, 1922, in ALEFE).⁴

On December 1923 Keynes' *A Tract on Monetary Reform* was published. It was largely based on Keynes' articles published in the previous years and above all in the supplements of the *Manchester Guardian*, except for the last two chapters, which included some radical proposals which Keynes had begun to formulate some month previously in the summer of 1923, and which were the response to the problem expressed in the quoted letter to Einaudi of April 30, 1922: "the next thing to do is to concentrate on some method of avoiding the present seasonal fluctuation". In the *Tract* Keynes proposed a managed currency policy in order to stabilize price levels. To achieve such stabilization, it was necessary to stabilize the money demand through credit control. For this purpose, Keynes believed that it was necessary to abandon the gold standard. He described it as "a barbarous relic" – whereas in the articles of the previous year he had held the more traditional opinion concerning the gold standard: that it was able to ensure the stability of the currency exchange rate but not that of domestic prices. The reactions to these unorthodox proposals were largely unanimous in judging them unfeasible or harmful, even if they recognized the brilliance of the book. This critical opinion was shared by many economists at that time very close to Keynes, like Pigou and Hawtrey, who thought that abandonment of the gold standard was too risky, and not just by economists distant from the English theoretical and political environment, as were most of Italian economists of that time (Asso 1982, Pavanelli 1993). One therefore understands why Einaudi, who did not hesitate to define the *Tract* "a real gem" (Einaudi 1924a) and "wonderfully clear" (Einaudi 1924b), raised doubts concerning Keynes' more heterodox proposals. Just before publication of the *Tract*, on 14 October 1923, in an article in the *Corriere*, Einaudi wrote, referring to the English situation, that "whatever the reasonable objections are against a deflationary policy, we have to recognize that they were acceptable in 1919 and in 1920 but today may be considered anachronistic" because the pound was near to the gold parity. This, Einaudi added, did not hold for Italy, and he continued:

If a country's monetary regime were governed by men like Keynes and [Gustav] Cassel distinguished theoreticians of money, perhaps greater perfection might be attained, but perhaps also serious errors might be committed. Gold is a coarse

⁴ The method of avoiding the present seasonal fluctuation to which Keynes refers in the letter was identified in the control of credit volume by the banking system, a main subject of Keynes' *A Tract on Monetary Reform* of 1923.

material and it is subject to mistakes, but these are mistakes independent from human arbitrariness and from the devices of economists.

In April 1925, the United Kingdom returned to the gold standard. In that summer, Keynes published *The Economic Consequences of Mr. Churchill*, a severe critique of the British government's action. Einaudi did not review the essay. But in a 1926 note in the *Riforma Sociale* on *The First Year of the Gold Standard* (Einaudi 1926), a book by the English LSE economist T.E. Gregory, he wrote that:

As regards England, Gregory's small book is an useful antidote to the articles written in the *Nation* by Keynes and his celebrated *The Economic Consequences of Mr. Churchill*.

However Einaudi recognized that the British decision to stabilize 'at the highest value' entailed the consequence of a long 'crisis of adjustment' perhaps justified, as Gregory maintained, by the advantages deriving from the "restored financial consideration of the country" (Einaudi: 575).

After April 1922, the correspondence between Einaudi and Keynes ceased.

In light of this reconstruction, we may say that the intellectual relationship between Einaudi and Keynes terminated in the last part of 1923 on the issue of managed currency, which Einaudi regarded as an unorthodox and risky practical proposal. After the *Tract* Einaudi's dissent increased and widened to encompass the theoretical framework, practical proposals and ideological vision. Einaudi expressed his position – on the basis, as he wrote, of the traditional classical and neoclassical wisdom – through long review-articles published in the *Riforma Sociale* on Keynes' various books, from *The End of Laissez-faire*, through the *Essays on Persuasion*, to *The Means to Prosperity*, when Einaudi's criticism reached its highest point, and he became conscious of Keynes' marked detachment from the orthodoxy.

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APPENDIX A

LETTERS BETWEEN EINAUDI AND KEYNES

46 Gordon Square,
Bloomsbury.

2nd March, 1922.

Dear Professor Einaudi,

The "Manchester Guardian" are bringing out a series of Special Supplements on the Reconstruction of Europe, beginning in April, which will be under my editorship. The Supplements will be on a considerable scale, and will aim at securing the collaboration of leading authorities in all countries. Be published in the leading European languages, as well as in English, and in particular an edition will be published in Italian and sold at a low price for circulation throughout Italy.

The fifth of these Supplements, dealing with the National Finances of Europe, will appear about the beginning of June, and I write to ask whether I could secure a contribution from your pen for this issue. I very much hope that you will be able to undertake it. My idea would be that the chief general article, on the financial and budgetary position of Italy, should be by yourself. I am also asking Signor Luzzatti and Signor Beneduce for shorter contributions to this issue; and I may possibly invite something from Signor Stringher. I am also hoping to get contributions to other numbers of the Supplements from Orlando, Nitti, Turati and many others.

It is probably not necessary that I should sketch out in any detail the precise scope of the article which I have in mind. I can safely leave this to you. But the chief points would be the true budgetary position of Italy; looking ahead, your own ideas as to the possibility of further taxation and your general prophecy as to the practicability of balancing the budget without recourse either to loans or to note issues, and of keeping up balances during the years in front of us.

I enclose a paper which gives some further particulars as to terms, etc., and I need not say how glad I should be personally to secure your collaboration.

Yours sincerely,
J.M. Keynes

Professor L. Einaudi
"Corriere della Sera",
Milan,
ITALY.

Torino (9) Italy
16 Piazza Statuto
8 III 922

Dear professor Keynes,

I have received your letter of March 2 and I will be glad to send you the requested contribution on the financial and budgetary position of Italy before April 20.

I hope you have seen an article which I have published on February 26 on your Revision of a Treaty. I think a copy was duly sent to [...] Macmillan and Co.

Yours truly
Luigi Einaudi

Turin, April 25, 1922
Piazza Statuto 16

Dear professor Keynes,

I send you the article to which I would give the title *Italian financial difficulties and prospects*. I have written it in Italian and I lack absolutely the time to translate it into my dubious English. I prefer to have it sent to your present address, as you can perhaps find at Genoa a suitable translator. I should like to revise the English text before publication; and I should not feel easy if I could not revise it.

Perhaps, as you have said to signor Caprin, I will call on you shortly, but in that case I will send you a telegram.

I will gladly hear if the manuscript has been safely delivered to your address.

Yours truly,
Luigi Einaudi

At Hotel Miramare,
Santa Margherita.

King's College,
Cambridge.
30th April, 1922

Dear Professor Einaudi,

Your article on the Italian Finances, for which I am very much obliged, has reached me safely. I have sent it to the translators and will let you see the English text. There will be plenty of time for revision, since according to my present

plans the issue of the supplement on Public Finances will not appear before the end of June.

I was most delighted to read your article in yesterday's *Corriere* commenting on myself. I half thought when I wrote that I might perhaps be giving you a good opportunity for speaking out decisively on this matter. Although I am a little more optimistic than you are about the possibilities of the situation, there is really very little difference between our opinions. We both agree that the immediate problem is to persuade the world that a return to the pre-war parity is an absurdity and that the next thing to do is to concentrate on some method of avoiding the present seasonal fluctuation, which can perhaps be treated separately from the more difficult problem of progressive depreciation due to unsound Government finance.

Yours sincerely,
J.M. Keynes

Professor L. Einaudi.

APPENDIX B

THE FINANCIAL PROSPECTS OF ITALY

Manchester Guardian Commercial, 1922

LUIGI EINAUDI

The literature published by the Governments and the experts of those countries which participated in the late war about their own financial situation, their immediate prospects, and the possibilities of balancing their Budgets has been too often inspired by a purpose. This purpose was not always the same; at one moment Germany was anxious to demonstrate the impossibility of meeting the reparations demands; at another moment Italy and France wished to persuade their financially stronger Allies that their effort during the war had been not inferior but actually superior to that of the richer nations if relative wealth were taken into consideration. Often the official or semi-official compiler found himself a prey to conflicting sentiments: "Shall I say that Italy has reached the utmost limits of taxability and cannot establish new taxes without ruining the taxpayers? I shall then have shown that the repayment of debts or even of the interest upon them to England or to the U.S.A. is an absolute impossibility; but I shall at the same time have demonstrated that the present situation is desperate, that if the Budget deficits have already been reduced from twelve to five milliards and will be further reduced to three milliards of lire in the current year the miracle cannot be repeated, because the taxes cannot realise more than they do at present, and that consequently we are condemned for an indefinite period to a deficit." Anxiously considering the possible effect of his words and the purpose of his argument, the writer will be so determined to avoid Scylla that he falls headlong into Charybdis. It is for this reason that so great a part of the official and propagandistic literature dealing with the financial situations of the European States, and among them, equally but not more than others, Italy, is so unconvincing. I will therefore endeavour in the present sketch of Italy's financial position to write without any set purpose and without considering the possible effect of my words. In this as in every other problem the solution best calculated to further the interests of one's own country is to tell the truth, or what one believes to be the truth. Lies have short legs; now that so many gifted and Argus-eyed experts are engaged in scrutinising the Budgets of the European States it would be a ridiculous expectation of a miracle to hope to conceal either the pleasant or the unpleasant aspect of our situation.

In point of fact there are good reasons for being optimistic. A State which came into the world with a deficit of 446.46 million lire (the first unified Budget

in 1862 showed a revenue of 480.26 and an expenditure of 926.72 million lire), a deficit increased in 1866 to 721.45 millions (the difference between 617.13 and 1,338.58), and nevertheless by 1876 had a surplus of 20.7 million lire (the difference between 1,123.3 and 1,102.6); a State which in the time of Crispi (1888-9) had come once more to have a deficit of 235.4 millions (the difference between 1,500.8 and 1,736.2), but in which in 1897-8 the expenditure had been reduced to 1,620 and the revenue increased to 1,629.5 millions, with a surplus of 9,5 millions; such a State need certainly not lose heart in face of new difficulties or give way to the thought that a balanced Budget is a wild dream! The figures are, it is true, incredibly swollen; we talk of milliards of lire with a lightness that would have appalled our fathers. But the recuperative powers of the Italian Budget are not yet extinct. If we examine the last Budget speech of the Minister of Treasury De Nava, made before the Chamber of Deputies on December 1, 1921, we find that the State Budget is based on the following figures, in millions of lire: -

	1920-1921	1921-1922 Estimated	1922-1923 Estimated
Actual expenditure	28,783.5	21,083.5	18,525.3
Various expenditure not comprised in the above	1,045.5	834.3	190.3
Total expenditure	29,829.0	21,917.8	18,715.4
Actual receipts	18,071.0	16,977.9	15,763.6
Difference	11,758.0	4,939.9	2,952.0

The improvement shown is clear, continuous, and cumulative. It is due to various circumstances. In the first place, certain great heads of expenditure show continuous reduction: the army and navy, which in 1920-21 were costing 5.1 milliard lire, in 1921-2 cost only 3.2 milliards, and are estimated for 1922-3 at 2.5 milliards. The subsidies on corn and other foodstuffs formerly weighed extremely heavily on the State Budget, and so lately as 1920-21 took up the sum of 1.6 milliards. This item is presumed to be non-existent for 1922-3. The principal, probably the only, financial achievement to the credit of the Giolitti Ministry was its battle for the passage of the Law of February 28, 1921, in which the subsidy paid by the State to keep down artificially the price of bread was practically abolished. Further, the expenditure on reparations in the devastated provinces is bound to diminish rapidly. Even when we take into account other heads of expenditure which must increase, above all those connected with social legislation and with public debt service, expenditure as a whole should tend to diminish. At all events, the expenditure resulting from laws now in force and from obligations already incurred shows such a tendency.

It must, however, be noted at once that the figures contained in the above résumé do not give an exact reflection of the real situation such as would result from a substitution of the actually realized figures for the years 1921-2 and 1922-3 for the estimates given above. The expenditure will certainly turn out to be greater than 21.9 and 18.7 milliards respectively. Even during the year it was found necessary to

increase the figures for 1921-2 from the original estimates of 20.2 to 21.9 milliards, as given by Signor de Nava last December, and Signor de Nava himself added that this figure will probably not be final, but will attain to not less than 22.5 milliards of lire. Probably also the figures of 18.7 milliards estimated expenditure for 1922-3 will be surpassed, and may eventually reach 20 or 21 milliards of lire. In any event Parliament is inviting the Government to present new bills entailing expenditure. The representatives of the people are obliged to satisfy the demands addressed to them on behalf of Government servants, pensioners, public works, unemployment benefits, war victims, &c. Little resistance is offered to these demands for fresh expenditure. The bad habit, contracted during the war, of abandoning the composition of the laws to the executive power has cleared the path for increases of expenditure. The necessity for obtaining the approval of Chamber and Senate for every new head of expenditure by means of a special law used to put a rein on expenditure. To-day a legal decree issued by the Government suffices to engage the State for huge sums. The press has protested and the Senate has protested against the abuse of this legislation by decree, but the abuse continues because the members of the various parties in the Chamber, Democratic, Socialist, or *Popolari*, find themselves better able to secure favours and concessions entailing expenditure by urging the Government to issue a decree than they would be if all expenditure had to pass through public discussion in both Chambers before being approved. This is one of the principal dangers which menace the Italian Budget - the increased public expenditure resulting from the political pressure of local and sectional interests.

Yet I do not believe that even such increased expenditure will bring the deficits for 1921-2 and 1922-3 above the estimated figures of five and three milliards respectively: they may even be lower. The Italian Ministers of Treasury, in order to combat the consequences of increased expenditure, are accustomed considerably to under-estimate the revenue at the beginning of the year. For example, if in 1921-2 the expenditure reaches 22.5 milliards instead of 21.9, it is equally certain that the actual revenue will be considerably above 17 milliards. The deficit will perhaps not be greater and may well be less than five milliards. The revenue for 1922-3 was estimated very cautiously, and it is not rash to suggest that, instead of 15.8 milliards, the Treasury will realise 17 or perhaps even more. The Ministers of Treasury employ this policy of under-estimating receipts precisely in order to secure for themselves a concealed reserve for meeting demands for new expenditure. In so doing they believe themselves to be acting in the interests of the State - alarming the Deputies with a heavy deficit and so dissuading them from demanding fresh expenditure. Even if they are obliged to yield, the deficit will at least be no greater than had been foreseen: the fresh expenditure will only use up the secret reserve derived from excess revenues. I doubt very much if this is a wise policy. It might have some measure of success if the reserve so formed were really concealed and impossible to foresee. When, however, it is a matter of common knowledge that such a reserve exists, and that the Ministers of Treasury always keep their estimates of receipts well below the reality, this in itself is an encouragement to new expenditure. Has the Minister of Treasury not declared that a deficit of five or of three milliards is foreseen? If it is foreseen, why reduce it or annul it, and if there are receipts in reserve why not utilize them for fresh expenditure?*

[*This article was written at the end of April and the passing of two months, while falsifying my prophecies on the probable amount of the deficit, demonstrated the importance of the first danger which in the text I said was threatening the stability of the Budget. Signor Paratore, writing the report of the Parliamentary Financial Committee of the Chamber of Deputies, values at 7,769 million lire the deficit for 1921-22, which is reduced to 6,863 millions if one takes into account the yield of various taxes pertaining to 1921-22 but postponed to subsequent years. The increase is due to increased expenditure: 610 millions of additional State railways deficit; 100 millions of additional losses on bread, coal, and other State provisions enterprises; 738 millions of expenditure consequent to war, &c.

The encouragement to expenditure given by the practice of keeping estimates receipts well below the reality seems thus to have been only too effective. The stream of new proposals of expenditure has been increasing so furiously that at length public opinion is awakening.

Voices are being raised in Parliament advocating a policy of economy and of drastic reductions in expenditure.

A "Geddes" report is said to be urgent in Italy, where old men recall times in which, thanks to rigid administration by Sella before 1876 and by Sonnino after 1894, the Budget was saved from wreckage and ultimately balanced. It is to be hoped that the economy movement will be successful, so that the first condition of salvation put in the text will be fulfilled.]

Over and above this first danger of a tendency to increase the public expenditure, a second menace to our finances is the exceptional and temporary character of certain important heads of revenue. For instance, among the direct taxes the tax on excess profits resulting from the war and the tax on properties which have appreciated as a result of the war, two taxes now combined in one of 100 per cent known as the total restitution of war profits tax, realized in 1920-21 the sum of 1,991.5 [*rectius* 1,991.5] million lire, and are estimated to produce 1,450 and 900 millions respectively in 1921-2 and 1922-3. The sums now exacted are only remainders, because the tax no longer touches profits made since June 30, 1920. Little by little as the arrears are paid the receipts will diminish and finally disappear. Similarly, is it possible that the revenue of 309 millions obtained in 1920-21 from the tax on abnormal bank-note circulation should be repeated many years? There are other receipts, omitted here for lack of space, which are bound to fall as conditions become once more normal.

But the most serious unknown quantity in Italy's, as in so many other European Budgets is the future of the currency. What would be the result of a serious rise in the value of the Italian lira above the present level? On this question it seems that practice and the theories of Italian financiers have little to do with one another. In practice the Treasury and issue banks make every effort to prevent a further increase of the paper circulation; at the same time they do not take any particular steps to reduce it. The net result is that the quantity of notes in circulation has for some time been stationary. The total was lire 20,087.3 millions on June 30, 1920, 22,001.0 on December 31, 1920, 20,427.3 on June 30, 1921, 21,447.2 on December 31, 1921 and 20,419.9 on February 20, 1922. In spite of more or less perceptible variations from time to time, the quantity of notes in circulation tends

to be stabilised at a little above 20 milliards. This, however, does not avail to effect a stabilization of the exchange rate of the paper lira against gold standard currencies: too many other elements besides the absolute quantity of notes in circulation influence the exchanges. We have, however, here an indication that in practice those responsible for Italy's financial and monetary policy think it best not to introduce too great changes in the aspect of things as they are. The aspirations of the responsible financiers, as expressed in words, are, however, quite different. They consider and proclaim that the lira is under-valued, that it is desirable that it should rise, and there are even those who predict that it may return to its former gold parity. Probably the doctrinaire aspirations and the verbal invocations to the former gold parity are not destined to have any influence on the practical conduct of Ministers of Treasury. The circulation will remain for a considerable time what it now is, since it is for many reasons extremely difficult to effect a serious reduction of it. And without such a reduction a return to the old parity is impossible. None the less, even a simple aspiration is not without significance: it indicates the existence of a state of mind which if it could have any practical outlet would seriously upset the State's finances. To regain equilibrium it is absolutely necessary that the total expenditure should fall below 18 milliards, but it is equally necessary that the receipts should reach that sum. If we remember the expenditure of municipalities and provinces, it is necessary that the Italian taxpayers should pay into the Treasury more than 20 milliards of lire a year as rates and taxes. But for the taxpayers to be able to pay 20 milliards a year they must have an income sufficient to cover this and to leave a sufficient margin for the necessities of life. Before the war the taxpayers paid three milliards of underpreciated lire yearly as taxes. To-day they are able to pay 20 milliards of depreciated lire because they have an income (calculated in this same depreciated currency) at from 60 to 80 milliards. It is a heavy burden to have to pay from a third to a quarter of one's own income to the State as taxes, but it can be borne. If, however, the lira were to appreciate and to approach once more its par value as responsible Italian financiers seem to wish, prices also would fall, the taxpayers' incomes would be reduced, the national income would become once more 20 to 30 milliards in place of 60 to 80. How can taxes of 20 milliards be raised on a national income of 20 to 30 milliards? The idea is absurd.

So far, it has been a question of doctrinaire opinions, opinions none the less dangerous for finance. We can already observe certain symptoms of the difficulties caused by the appreciation of the lira. The dollar exchange has improved from a maximum of 28 lire to the present rate of 18, and the sterling exchange has moved correspondingly. This has been enough to cause a serious embarrassment to many manufacturers and traders. Those who had purchased raw materials at high prices have suffered severe losses. Export to foreign countries has become less profitable. Consequently the taxpayers lament the increased pressure of taxes. The Government has been obliged to concede reductions and delays in payment of the arrears on the war profits tax. The tax collectors experience increasing difficulties in realizing the proportionally increased taxes upon taxable incomes. If the policy of appreciating the lira were put into practice and prices were seriously reduced, it would be impossible to balance the Budget. The expenditure cannot be reduced. Of 18 milliards of State expenditure at least six come under the heading

of public debt, and are therefore unalterable. Another six represent salaries and payments to public servants, which in practice no Government has the political strength to reduce. The remaining six are partly expenses fixed by contract. The margin of possible reduction is very small. It is therefore to be hoped that whatever theory be adopted by statesmen to keep public opinion quiet, in practice they will keep it in mind that it would be extremely dangerous for the equilibrium of the State finances that the lira should return to or even approach its former gold parity. At the present rate of the lira a balanced Budget is a possible ideal capable even of realization at a not too distant date, whereas with the former parity it would be impossible now and for a long time to come.

These two dangers once overcome - that is, the weakness of the Government and of Parliament in the face of demand for new expenditure and the agitation for the rapid restoration of the former value of the lira, the first being an actual and urgent danger, the second a danger of doctrinarism and of the written world, - the finances of Italy will have to face a third difficulty - namely, that of obtaining fiscal receipts of not less than 20 milliards of lire through the State, provinces, and municipalities, and at the same time reducing the extravagant rates of taxation now attained in Italy. Praise is due to Italy's Ministers of Finance and Treasury* [*As is well known, we have in Italy two Chancellors of the Exchequer - a Minister of Treasury at the head of the Treasury proper who controls the spending Ministries, receives the revenue, orders payments, and administers the public debt; and a Minister of Finance who supervises the administration of direct and indirect taxation. To make a rough comparison with British Institutions, it may be said that the Ministry of Treasury corresponds to the British Treasury, while the Finance Ministry has the more restricted function indicated in English by the names of "Inland Revenue and Customs and Excise Departments."] since 1914 for the zeal, ardour, and courage which they have shown in imposing new and augmenting old taxes. They have thus obtained important results. Being politicians, however, they not infrequently followed the line of least resistance, and faced with two possible taxes - one just and scientific but difficult to apply owing to the shortage of incompetence of the personnel and the resistance of taxpayers, the other a popular tax easily realizable - they reserved their praise for the first but in practice adopted the second. For this reason we have in Italy a general project of reform of the income tax presented to Parliament by the Minister Meda in 1917 transformed into a law by decree November 24, 1919, No. 2,162, by the Minister Tedesco, and augmented by the Minister Soleri in a bill of November 25, 1921. This scheme is inspired - with necessary modifications - by the English income tax and super tax, the reformed French system of direct taxation, and the North America system of income taxes. But although sanctioned by a decree and so having the same force as all other laws by decree, it has not yet been applied. It should have entered into force on January 1, 1921, but its application was put off first to January 1, 1922, then to January 1, 1923, and it is to be expected that further postponements will necessarily be conceded. The aim of the scheme is an equitable distribution of taxation so as not to weigh much on some and little on others, but long preparation is indispensable. Consequently while the ideal of the reform exists in theory and is the object of admiration as a museum curiosity, in practice the Ministers of Finance and Treasury

attempt to extract money by the existing taxes. Antiquated and unfair as they are and often devoid of any reasonable justification, the old taxes nevertheless exist and are productive. Who is so rash as to disturb them at a moment when money is so urgently required? So the old taxes remain in force, and are made to yield ever-increasing amounts. The courage shown by Italian Ministers in aggravating the customary burdens and the heroism shown by the taxpayers in supporting the ever-increasing weight are really worthy of admiration.

I give below an illustration of the proportion per cent of incomes claimed by the three old income taxes - that is, the tax on landed property, that on buildings, and that on movable property, which together correspond to the British income tax, less super tax:

	1914			1922		
	State	Provinces and Municipalities	Total	State	Provinces and Municipalities	Total
Incomes derived from personal estate:						
A. Derived from capital alone -						
1. Interest on public debt	20.40	-----	20.40	25.87	-----	25.87
2. Interest on loans to private persons	17.60	-----	17.60	25.37	-----	25.37
B. Derived from a combination of capital and labour (industrial and commercial)	11.73	-----	11.73	12.93 to 20.10	2.00 to 3.60	14.93 to 23.70
C. Earned income (professional men and private employees)	10.56	-----	10.56	11.64 to 18.80	1.80 to 3.20	13.44 to 22.00
D. Earned income (public employees)	8.80	-----	8.80	9.32 to 9.70	-----	9.32 to 9.70
Incomes derived from						
House property	16.50	22.72	39.22	20.72 to 27.74	49.61	70.33 to 77.35
Landed property	8.80	30.27	39.07	11.89 to 19.15	97.13	109.02 to 116.28

It should be observed that the burden of direct taxation upon incomes is not confined to the above. Further taxes are levied on the same incomes, as, for instance, the *extraordinary war tax*, which for many taxpayers adds a further 25 per cent to the State taxes; a so-called *complementary tax upon incomes higher than 10,000 lire*, which is only nominally a progressive supertax upon the taxpayer's total income, being in reality an ill-ordered and partial additional tax of between 1 and 8 per cent on certain incomes; the *tax on business and trading concerns*, which is a second additional tax on incomes derived from personal estate of category B and certain of category C. It is impossible to make with any degree of accuracy a summary calculation of the total extent of taxation on incomes owing to the diversity of such taxation on different kinds of income and the variations according to the province of municipality from which the income is derived. Keeping in mind the above-mentioned variable additions, it may be said that landowners pay on an average from 110 to 130 per cent of their taxable assessment, while owners of buildings pay between 70 and 93 per cent, those deriving their income from capital investments between 35 and 39 per cent, traders and those engaged in commerce between 15 and 39 per cent, professional men and private employees between 12 and 36 per cent, and public employees about 10 per cent. In the case of owners of land or buildings the variations from the average are very considerable, and may bring the rate of taxation up to 200 per cent or even more of the income. Even apart from this, the percentages paid are surprising, and indicate that the pressure of taxation in Italy is not really what it seems. How is it, in fact, possible that landowners should pay every year between 110 and 130 per cent of their incomes? How is it possible, in view also of the fact that the income taxes form only a section of the taxes weighting upon incomes derived from capital, and that at least the extraordinary tax on capital and the death duties must be taken into account? Both these taxes are far from light; the tax on capital varies between 0.225 and 2.5 per cent per annum on the value of the property over 20 years; while the death duties vary between 1.80 and 32.40 per cent in case of property transmitted from parents to children and from 21.60 to 90 per cent for inheritances by relatives outside the fourth degree or by nonrelatives; with a further addition of 6 to 12 per cent in all cases when the heir possesses a property of more than 200,000 lire.

It is obvious that effective and general payment of taxes of this fantastic nature is practically impossible. Such high percentages are only possible where taxable incomes are reckoned much under their true value. Incomes derived from land are often valued at 50, 20, 30 or 10 lire for every 100 lire of their true value; those derived from buildings are valued at 50 or 75 lire where they should be calculated at 100. This consideration brings the pressure of Italian taxation from the realm of delirious imagination back to that of reality, without, however, diminishing the gravity of the problem. Even reduced to their true measure the sums are high. Modest artisans, tradesmen, and professional men pay 20 or 30 per cent on exiguous incomes of 3,000, 5,000, or 10,000 lire a year, corresponding at the present exchange rate of 80 lire to £40, £60, or £120 a year. In certain cases the true income is equal or inferior to the taxes paid; this applies to many fixed incomes, land or house rents, which the law forbids to be raised. In these fairly numerous

cases the income is insufficient to pay the taxes, and the owner, to retain his land or house, sacrifices thereto a portion of his other incomes simply in the hope that things may change in the future. The consequence of this is that a large and growing proportion of taxpayers feel themselves to be and are in reality subject to an oppressive rate of taxation, and oppose any increase of taxation. True, there are still many taxpayers who could pay more, but for others the present taxes are ruinous. This, then, is the third danger menacing Italy's finances at the present moment, the maladjustment which prevents a further increase of taxes which would ruin certain taxpayers, while others are still let off lightly. Here, then, is the real saving mission of finance - to reduce the percentages from 30, 70, 120 or 130 per cent, which are really absurd, to more tolerable levels. In view of the fact that the supplementary taxes - namely, the tax on inheritance and the death duties - are still in existence, the income taxes ought to be so adjusted as not to exceed 10 per cent for the lowest incomes, nor to go beyond a maximum of 40 per cent for higher incomes. This is substantially the aim of the Meda-Tedesco-Soleri reform already mentioned as having been decreed. Such empirical methods as indefinite increases of existing taxes which infuriate the taxpayers and drive them to resist investigation of their true incomes must be abandoned, as must be also the false notion that it suffices to heap tax upon tax to obtain more money.

Fortunately, the opinions of Italian financiers are beginning, though only gradually, to move in this direction. After the stormy, disordered, tub-thumping period of war finance between 1914 and 1921, the view that moderation and simplicity are profitable virtues in finance is beginning to gain ground. Proof of this fact may be found in the recent development of the tax on incomes derived from movable property. This tax, although very high, yet does not, even with the addition of various supplements, reach 40 per cent, while the taxes on land and buildings reach 130 and 93 per cent respectively. Consequently, while the taxable income from land and buildings is almost stationary, the income liable to the tax on movable property is rapidly increasing; it increased between 1918 and 1920 from 2,030.8 to 2,785.9 million lire. After 1920 the increase was even more striking because the taxpayers were no longer intimidated by the 100 per cent tax on excess war profits, which, as mentioned above, ceased to be applied on June 30, 1920. In 1922 the taxable income had reached the sum of 6,002.7 million lire. Beyond doubt there are still rich harvests to be reaped out of incomes could a method of taxation be imposed which was at once simple, moderate and equitable. The same may be said of indirect taxation on articles of consumption. The danger here arises from the extreme Protectionism inspiring the new fiscal tariff of July, 1921, with its thousand and more items so taxed as to prevent import. But the direct taxes on consumption give excellent results; for example, the revenue from the salt, tobacco, match, and playing card monopolies leaped from 547.1 million lire in 1913-14 to 3,535.4 million lire in 1920-21.

I must now draw to a close. Nothing is more likely than that in about two or three years the public revenue from taxation received by the State, the provinces, and the municipalities will have attained stability at the 20 milliards, approximately, which are required to meet the expenditure. This, however, only on three main conditions:

That a rein be placed on new expenditure.

That no attempt be made to restore the paper lira to its old parity.

That the rates of taxation be moderated and its burden more evenly distributed.

If these conditions be fulfilled Italy's financial problem may be considered as solved. I should like to have dealt with the period of transition, in which new liabilities must be incurred with the necessity of consolidating our floating debt, now in the form of Treasury bonds up to the unwieldy figure of 32,000,000,000 lire, but space forbids this discussion. However, these are technical questions concerning credit; once the principal difficulty is resolved their solution will follow easily. This principal difficulty is the fulfilment of the three conditions noted above, on which depends the salvation of Italy's finance. That this salvation will be realised is certain, provided the Italians go sufficiently seriously to work.

It is, of course, implied that they must be aided and encouraged in this by the solution of a final formidable problem hanging like the sword of Damocles over the finances of all the Allied States of the Continent - namely, the cancellation of the inter-Allied debts. This is the absolutely indisputable international premise without which the national problem cannot even begin to be faced. If the inter-Allied debts be not purely and simply cancelled, what Italian statesman could attempt to scale these inaccessible Everests? To get rid of a deficit of a three milliard lire is a tangible task which can be faced, but if to these three milliards were joined five or six more milliards of paper lire, the sum necessary for the service of the 22 milliards of gold lire owed abroad, the attempt would be *ultra vires*. No individual, no party could conceivably heap up the burden of taxation to the necessary degree. This essential truth must be stated without periphrases, without ambiguities or reticences or hazardous compromises. The creditor States must be told clearly and firmly that Italy is quite in a position to solve the problem of her Budget - if she is freed from the incubus of foreign debts. Otherwise we shall move forward towards an increasing and irremediable financial anarchy.